

Subject: FW: [/] Equity Derivs: FXI can outperform SPX coming out of the G20
From: Nadean Novogratz <[REDACTED]>
Date: Thu, 15 Nov 2018 10:59:29 -0500
To: Paul Barrett <[REDACTED]>
Cc: Martin Zeman <[REDACTED]>, Stewart Oldfield <[REDACTED]>, Alan Brody <[REDACTED]>

Hi Paul,

Interesting FXI upside trade out to February below. Is international underlyings interesting to you?

Kind regards,
Nadean

From: Karthik Nagalingam [mailto:[REDACTED]]
Sent: Thursday, November 15, 2018 10:33 AM
To: Karthik Nagalingam
Subject: [/] Equity Derivs: FXI can outperform SPX coming out of the G20

Classification: Public

Can China Rip after G20?

Even with Brexit negotiations going back and forth, oil trading like it is 2016, and the SPX continuing to trade lower. The questions I have fielded the most this week are about Chinese upside ahead of G20 in 2 weeks. This is a trade that people have been looking to put on a while, and while conviction may not be sky high, there is clearly a feeling of not being able to miss it – that points to low premium option ideas.

Our House view remains constructive on a deal getting done and China's economy turning around.

- The prospects of a trade deal have improved and our strategists are now up to a 50% likelihood of a deal being reached on Nov 29
- President Trump has asked his cabinet to draw up a potential deal. The president sees the market turmoil, and while he likes to blame the Fed and the incoming Dem House, he would likely rather the market go back to rising.
- Slowdown can turnaround quickly in controlled economy. While we and most banks are downgrading China's GDP forecast given the trade war, a resolution along with continued accommodative fiscal policy in China can see that forecast reverse quickly.
- Recently announced personal income tax cuts in China, estimated to be ~0.5% of GDP, should boost retail sales and help offset downside risks to growth from the trade war
- Like FXI over EEM. Given the construction of the two indices, I like FXI better for a purer play on Chinese economic conditions improving. EEM has larger tech exposure (along with obviously other countries), while FXI has higher weights to consumer products and industrial cyclicals that can outperform if higher global rates re-rate growth.

2 Trades for a real Chinese recovery:

Vanilla – FXI Feb 42.5/48 Call Spreads for 96c (ref. 40.72, 28d) max payout 4.7x

- Breakeven on structure is ~5% away, structure sees FXI re-enter old trading range, while selling post Feb/March highs
- Feb gets near-term G20 catalyst, the big rate decisions over December (which can move USD), as well as the full announcement of Chinese fiscal policy early next year

Light exo – Feb FXI ATM call contingent on SPX <105% for 2.05% vs 4.15% vanilla

- FXI has started to outperform SPX over the last week, and if current fundamental factors keep the US down to only slightly up, FXI can continue to close the performance gap over the next 3M. Just look to today, SPX down 50bps, and FXI is trading 40bps higher.
- ATM FXI – 105% SPX is over 3.6% and so the contingency is cheapening the vanilla call 50% and similar structure 43%

While the recent SPX selloff has brought both markets closer, SPX is still massively outperforming on the year, and FXI can now continue to close that gap if the US underperforms even after the trade deal.

FXI implied vols are near 2 year highs, and 95/105 skew near flattest levels over same period, indicating investor expectation for upside here.

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Karthik Nagalingam
Equity Derivatives

Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
Tel. [REDACTED]
Mobile [REDACTED]
Email [REDACTED]

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